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No. 91-1513

In The

Supreme Court of the United States

October Term, 1992

United States Department of the Treasury and Mitchell A. Levine, Assistant Commissioner,
Petitioners

v.

George Fabe, Superintendent of Insurance, State of Ohio,
Respondent

On Writ of Certiorari to the United States Court of Appeals for the Sixth Circuit

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BRIEF OF THE NATIONAL CONFERENCE OF INSURANCE GUARANTY FUNDS AND THE NATIONAL ORGANIZATION OF LIFE & HEALTH INSURANCE GUARANTY ASSOCIATIONS AS AMICI CURIAE IN SUPPORT OF RESPONDENT

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INTEREST OF THE AMICI CURIAE

The National Conference of Insurance Guaranty Funds ("NCIGF") is an organization of the property and casualty insurance guaranty associations of the various states, the District of Columbia, Puerto Rico, and the U.S. Virgin Islands. These insurance guaranty associa-

tions are generally not-for-profit unincorporated associations created by special state statute. The statutes creating the insurance guaranty associations were almost universally based on the Post-Assessment Property and Liability Insurance Guaranty Association Model Act ("P&L Model Act") which was first promulgated by the National Association of Insurance Commissioners ("NAIC") in 1969.

The P&L Model Act, and the state statutes which it inspired, are intended:

> to provide a mechanism for the payment of covered claims under certain insurance policies, to avoid excessive delay in payment and to avoid financial loss to claimants or policyholders because of the insolvency of an insurer, to assist in the detection and prevention of insurer insolvencies, and to provide an association to assess the cost of such protection among insurers.

Consistent with that purpose, the insurance guaranty associations provide some limited protection to certain insureds in the event their insurance company becomes insolvent. The specific duties of these associations are defined and limited by the statutes creating them.[1] However, generally speaking, the guaranty associations pay "covered claims" which arise out of insurance policies issued by insurers which have become "insolvent insurers" as those terms are defined and limited by statute.[2]

The National Organization of Life & Health Insurance Guaranty Associations ("NOLHGA") is a not-for-profit association whose members are the life and health insur-

[1] For example, the Ohio Insurance Guaranty Association was established pursuant to Ohio Rev. Code Ann. § 3955.06 (Anderson Supp. 1991) and is governed by the Ohio Insurance Guaranty Association Act, Ohio Rev. Code Ann. § 3955.01 *et seq.* (Anderson Supp. 1991).

[2] P&L Model Act at Section 5(6); Ohio Rev. Code Ann. § 3955.01 (B) and § 3955.01(C) (Anderson Supp. 1991).

ance guaranty associations of the fifty states and Puerto Rico. Life and health insurance guaranty associations are generally not-for-profit, unincorporated associations chartered pursuant to state law to help protect life insurance policyholders, health insurance policyholders, annuity contract holders and certain other persons (hereinafter "insureds") against the failure of their insurance company. The scope of protection provided by these associations is limited and there is variation between the states as to the types of insurance obligations covered and the dollar amounts of those coverages.

Most life and health insurance guaranty associations were chartered under individual state enactments of the NAIC Life and Health Insurance Guaranty Association Model Act of 1987 (the "Life and Health Model Act") or one of its antecedents.[3] The official commentary to that Act states that its basic purpose is to "[T]o protect policyowners, insureds, beneficiaries, annuitants, payees and assignees against losses (both in terms of paying claims and continuing coverage) which might otherwise occur due to an impairment or insolvency of an insurer."

Like their property and casualty counterparts, life and health insurance guaranty associations require all companies chartered by or admitted into a state, which write the lines of business covered by the guaranty association, to become members subject to guaranty association assessments. Unlike their property and casualty counterparts however, whose principal constraint is to pay covered claims, life and health insurance guaranty associations generally seek to continue the long-term life, health and annuity obligations of a failed insurer by reinsuring those obligations with a financially sound reinsurer.

[3] The Ohio Life and Health Insurance Guaranty Association was enacted pursuant to Ohio Rev. Code Ann. § 3956.06 (Anderson Supp. 1991) and is governed by the Ohio Life and Health Insurance Guaranty Association Act, Ohio Rev. Code Ann. § 3956.01 *et seq.* (Anderson Supp. 1991).

But it is well to keep in mind that life and health insurance companies write any number of insurance products the contractual obligations of which (i) exceed guaranty association limits of protection or (ii) are not accorded any protection whatsoever. The estate of the failed insurer is the only refuge for persons with claims that exceed or are not covered by guaranty association protections.

The state insurance guaranty associations represented by NCIGF and NOLHGA are part of the comprehensive system enacted by the states to handle insurance company insolvencies. All guaranty associations work closely with state officials, typically the insurance commissioner, legally responsible for the rehabilitation, conservation or liquidation of a financially impaired or insolvent insurance company. The creation of guaranty associations by the states is but one example of how insurance company insolvencies have been handled under the aegis of state law, rather than federal law. The guaranty associations act as a limited safety net in covering certain obligations of insolvent insurers to their insureds and third-party claimants. Claims not covered by a guaranty association are generally submitted directly to the insurance company in liquidation to be handled by the liquidator. In those cases where claims are paid by a guaranty association, under state insurance insolvency laws the subrogation claims of guaranty associations have the same priority as claims of insureds.[4]

As a result of the above-described state based system of resolving insurance insolvencies, the insurance company liquidator and the appropriate insurance guaranty associations are the two primary sources of protection of insureds of insolvent insurance companies. Accordingly, the various state guaranty associations have a strong involvement and interest in the present system whereby the states determine the priority of claims

[4] See, e.g., Ohio Rev. Code Ann. § 3903.42(C) (Anderson 1989).

against insolvent insurance companies as part of the general, comprehensive state-based system of regulating the business of insurance.[5]

SUMMARY OF ARGUMENT

The United States Department of the Treasury (the "Treasury Department") has filed claims of approximately $10.7 million on various bonds issued by the now insolvent American Druggists Insurance Company ("ADIC"). The Treasury Department has asserted that its claims are entitled to first priority under 31 U.S.C. 3713(a)(1)(A)[6]. The Liquidator of ADIC, George Fabe, the Superintendent of Insurance of the State of Ohio, has maintained that the federal claims are entitled to fifth priority under the Ohio Insurers Supervision, Rehabilitation, and Liquidation Act, Ohio Rev. Code Ann. § 3903.01 *et seq.* (Anderson 1989 & Supp. 1991) ("Insurers Liquidation Act"). Under the Ohio statute, claims are paid in the following order: (1) administrative expenses, (2) wage and benefit claims, (3) policyholder claims, (4) claims of general creditors, and (5) claims of federal, state and local governments. Additionally, there are three lower classes of claims. Ohio Rev. Code Ann. § 3903.42 (Anderson 1989).

Given this conflict between the federal and state laws, the Treasury Department has argued that the Ohio law is preempted by 31 U.S.C. 3713(a)(1)(A). The Liqui-

[5] Pursuant to Sup. Ct. R. 37.3, the parties' written consents to the filing of this amici curiae brief have been filed with the Clerk.

[6] 31 U.S.C. 3713(a)(1)(A) provides that:

> A claim of the United States Government shall be paid first when—
>
> (A) a person indebted to the Government is insolvent and—
>
> (i) the debtor without enough property to pay all debts makes a voluntary assignment of property;
>
> (ii) property of the debtor, if absent, is attached; or
>
> (iii) an act of bankruptcy is committed. . . .

dator has countered that preemption of the Ohio law is barred by virtue of the McCarran-Ferguson Act, 15 U.S.C. § 1011 *et seq.* That Act provides, inter alia, that "No Act of Congress shall be construed to invalidate, impair or supersede any law enacted by any State for the purpose of regulating the business of insurance . . . unless such Act specifically relates to the business of insurance." 15 U.S.C. 1012(b).

Clearly, the federal general priority statute, 31 U.S.C. 3713, is not an Act that "specifically relates to the business of insurance." Hence the core issue in this appeal is whether the Ohio law regulating insurance company insolvencies, and, specifically, prioritizing claims against insolvent insurance companies, regulates "the business of insurance." Based on both the plain meaning of the statute and this Court's prior analysis of the scope of McCarran-Ferguson, NCIGF and NOLHGA believe the Ohio insurance insolvency statute clearly regulates the business of insurance.

1. The starting point in any issue of statutory construction is the plain language of the statute itself. If the meaning of the statute is clear on its face, there is no need to proceed any further. In the present case, the issue is whether the Ohio insurance code provision establishing the relative priorities of claims against insolvent insurance companies regulates "the business of insurance." The very essence of the business of insurance is the payment of insureds when potential risks become actual claims. Since the Ohio insurance insolvency statute determines, as a practical matter, if and how much an insured (or claimant) will get paid, the Ohio law clearly regulates the business of insurance.

2. If the Court moves beyond the plain language of the statute to cases interpreting it, it will not find any of its own decisions directly on point. However, this Court has recently decided three cases interpreting the phrase "the business of insurance" which support the

conclusion that the Ohio statute is the type of regulation covered by McCarran-Ferguson. *SEC v. National Securities, Inc.*, 393 U.S. 453 (1969); *Group Life & Health Ins. Co. v. Royal Drug Co.*, 440 U.S. 205 (1979); *Union Labor Life Ins. Co. v. Pireno*, 458 U.S. 119 (1982). The first of those cases held that the McCarran-Ferguson Act was concerned with matters such as the "relationship between insurer and insured," the "reliability" and "enforcement" of insurance policies, and the companies' "status as reliable insurers." 393 U.S. at 460. The Ohio priority statute gives a high priority to the claims of insureds against an insolvent insurance company. This increases the reliability of their policies and their ability to enforce them. This in turn enhances the relationship between the insurer and insured as set forth by *National Securities* so as to bring the Ohio priority statute under the protection of McCarran-Ferguson.

Royal Drug and *Pireno* analyzed three factors to determine if a practice by a state regulates the business of insurance:

a) "whether the practice has the effect of transferring or spreading a policyholder's risk"

b) "whether the practice is an integral part of the policy relationship between the insurer and the insured"

c) "whether the practice is limited to entities within the insurance industry"

458 U.S. at 129. The Ohio statute, which gives a high priority to insureds' claims, meets each of these three criteria. First, the priority assigned to a policyholder's claim will have a direct bearing and a major impact on whether the policyholder has in fact transferred the risk in the event his or her insurance company goes insolvent. Second, the most integral part of the policy relationship—from the point of view of the insured—is whether the insurer pays the claims it admittedly owes. The Ohio

priority scheme, which maximizes the likelihood of such payment in the event of insolvency, thus deals with a fundamental part of the relationship between the insurer and insured. Third, the Ohio Insurers Liquidation Act deals solely with the priority of claims against insurance companies. It does not attempt to regulate claims against any entities outside the insurance industry.

In sum, the Ohio Act comes within the clear meaning of the McCarran-Ferguson Act and within the meaning as analyzed by the prior decisions of this Court.

ARGUMENT

I. A STATE STATUTE WHICH PRIORITIZES CLAIMS AGAINST INSOLVENT INSURANCE COMPANIES REGULATES "THE BUSINESS OF INSURANCE" UNDER THE PLAIN MEANING OF THAT PHRASE AS USED IN THE McCARRAN-FERGUSON ACT.

The field of insurance has long been an area of dominant state concern. This Court held early on that "[i]ssuing a policy of insurance is not a transaction of commerce" *Paul v. Virginia*, 75 U.S. (8 Wall) 168, 183 (1868). It was therefore widely believed and held that insurance was not subject to federal regulation under the Commerce Clause. Thus, the Court surprised and raised great concerns within the insurance industry and the state and federal governments when it ruled in *United States v. South-Eastern Underwriters Ass'n.*, 322 U.S. 533 (1944), that insurance transactions are subject to federal regulation under the Commerce Clause in general, and the antitrust provisions of the Sherman Act in particular.

Congress reacted quickly to *South-Eastern Underwriters* by passing the McCarran-Ferguson Act, 15 U.S.C. 1011 *et seq.* That Act reflects the long-established national policy that insurance be regulated at the state level:

> Congress declares that the continued regulation and taxation by the several States of the business of insurance is in the public interest, and that silence on the part of the Congress shall not be construed to impose any barrier to the regulation or taxation of such business by the several States.

15 U.S.C. 1011. That general statement of policy was codified by the Congress in a specific provision which protects against preemption of state laws in this field by the federal government:

> No Act of Congress shall be construed to invalidate, impair, or supersede any law enacted by any State for the purpose of regulating the business of insurance . . . unless such Act specifically relates to the business of insurance: *Provided*, That after June 30, 1948, the Act of July 2, 1890, as amended, known as the Sherman Act, and the Act of October 15, 1914, as amended, known as the Clayton Act, and the Act of September 26, 1914, known as the Federal Trade Commission Act, as amended, shall be applicable to the business of insurance to the extent that such business is not regulated by State law.[7]

15 U.S.C. 1012(b).

[7] It is noteworthy that unlike the Sherman Act, the Clayton Act and the Federal Trade Commission Act, the federal priority law, 31 U.S.C. 3713(a)(1)(A) was not deemed by McCarran-Ferguson to be applicable to the business of insurance, even though the federal priority statute had been enacted long before McCarran-Ferguson. Furthermore, while Congress has subsequently declared other federal laws to be applicable to the insurance industry notwithstanding McCarran-Ferguson, it has never made such a declaration about 31 U.S.C. 3713(a)(1)(A). "[T]he Sixth Circuit has established that '[v]arious statutes enacted by Congress . . . have been amended to establish federal dominance in certain areas pursuant to the McCarran-Ferguson Act. Nevertheless, 31 U.S.C. § 3173, the federal superpriority statute has not been amended to that effect.'" *Garcia v. Island Program Designer, Inc.*, No. 91-1679, 1992 WL 106774 (D. Puerto Rico, April 21, 1992) (copy included in the Appendix at 15a) (quoting the Sixth Circuit decision in the present case).

This case presents a clear conflict between state and federal law. On the one hand, Ohio and all the other states have enacted a comprehensive statutory scheme regulating insurance companies from the cradle to the grave. A significant section of that code deals with insolvent insurance companies in general and claims against them in particular. The Ohio statute prioritizes claims against these companies as follows:

(1) Administrative Expenses,

(2) Wage and Benefit Claims,

(3) Policyholder Claims,

(4) Claims of General Creditors,

(5) Claims of Federal, State and Local Governments,

(6) Late Filed Claims or Miscellaneous Claims,

(7) Surplus or Contribution Notes, and

(8) Claims of Shareholders or Other Owners.

Ohio Rev. Code Ann. § 3903.42 (Anderson 1989). Insurance codes in other states set similar priorities for claims. Federal law, by contrast, contains a general provision which grants the federal government a first priority for its claims against a debtor who has become insolvent. 31 U.S.C. 3713. This statute does not relate to insurance companies in particular.

Normally in a situation such as this, the Commerce and Supremacy Clauses of the U.S. Constitution would require that the state law be preempted by the federal law. However, as noted earlier, Congress has expressly barred the doctrine of preemption from applying to state laws regulating the business of insurance unless the federal law at issue "specifically relates to the business of insurance." In the present case, there is no question that 31 U.S.C. 3713 does not relate specifically to the business of insurance. Its terms speak generally to cases where someone indebted to the United States has become

insolvent; the federal law does not mention or refer to insurance companies in any way. Thus, the present dispute turns on the question of whether the Ohio statute prioritizing claims against insolvent insurance companies regulates the business of insurance.

In deciding whether the Ohio law regulates the business of insurance, the threshold consideration is the language of the McCarran-Ferguson Act itself. *Pennsylvania Public Welfare Dept. v. Davenport*, 495 U.S. 552, 557-558 (1990) ("Our construction . . . is guided by the fundamental canon that statutory interpretation begins with the language of the statute itself."); *Mallard v. U.S. Dist. Court for Southern Dist. of Iowa*, 490 U.S. 296, 300 (1989) ("Interpretation of a statute must begin with the statute's language."); *St. Paul Fire & Marine Ins. Co. v. Barry*, 438 U.S. 531, 541 (1978). If the meaning of that language is clear and plainly applies to the Ohio law, then there is no need for any additional analysis. *Freytag v. Commissioner of Internal Revenue*, 111 S. Ct. 2631, 2636 (1991) ("When we find the terms of a statute unambiguous, judicial inquiry should be complete except in rare and exceptional circumstances."); *Burlington Northern R. Co. v. Oklahoma Tax Comm'n*, 481 U.S. 454, 461 (1987). In this case, the Ohio provision at issue falls within the clear and plain meaning of the phrase "the business of insurance."

Ohio Rev. Code Ann. § 3903.42 is part of a comprehensive state statute regulating all aspects of the business of insurance. See Ohio.Rev. Code Ann. Title 39 (Anderson 1989 & Supp. 1991). This comprehensive regulation of the insurance industry by the State of Ohio is typical of what is found in the other states as well. The regulation of insurance company insolvencies (Ohio Rev. Code Ann. Chapter 3903) is simply one part of this overall statutory scheme. It involves, *inter alia*, the appointment of a liquidator to marshall all the assets of the insurance company and the adjustment and payment of

claims against the insurance company. The insurance company is operated by the liquidator in most respects as an ongoing company, the primary exception being that it no longer takes on any new business during the liquidation proceedings. In other words, while the insolvency proceedings are pending, the insurance company continues to conduct most aspects of the business of insurance other than the solicitation of new customers and the issuance of new policies. For example, the liquidator may, and does, employ employees and agents;[8] conduct "the business . . . of the insurer;"[9] continue to prosecute and to commence in the name of the insurer any and all suits or legal proceedings;[10] enforce reinsurance contracts;[11] and collect unpaid earned premiums from any person.[12] The statutory scheme regulating insolvent insurance companies in Ohio is typical of the framework set up in the other states under the NAIC's Insurers Rehabilitation and Liquidation Model Act (1991).[13]

All of the regulations established by the Ohio statute, including the priority scheme, are designed to see that the *raison d'etre* of insurance—the payment of insureds' claims—in fact occurs:

> Up until the time there is a claim and a payment is made, the only tangible evidence of insurance is a piece of paper. In other words, the real product of insurance is the claims proceeds. Selection of the prospect, qualifying him for coverage that suits his needs, delivery of a policy, collecting premiums for perhaps years, making changes in coverage to meet changing situations, all of these are but preambles to the one purpose for which the insurance was secured, namely to collect dollars if and when an unforeseen event takes place.

J. Wickman, *Evaluating the Health Insurance Risks*, 57 (1965). Thus, the state priority scheme falls within the plain and commonly understood meaning of the phrase "the business of insurance." It is the business of insurance to pay claims when a possible risk has blossomed into an actual claim. That act, more than any other act in the field of insurance, is what is commonly understood to be the business of insurance. Ohio Rev. Code Ann. § 3903.42 insures that the commonly understood meaning of the most basic business of insurance is a reality, even in those instances when an insurance company has become insolvent. As such, it is well within the meaning of the phrase "the business of insurance," if in fact not at the very core of that phrase. Accordingly, the McCarran-Ferguson Act dictates that the Ohio statute is not preempted and that Ohio law controls the disposition of all claims against American Druggist Insurance Company.

II. A STATE STATUTE WHICH PRIORITIZES CLAIMS AGAINST INSOLVENT INSURANCE COMPANIES REGULATES "THE BUSINESS OF INSURANCE" AS THAT PHRASE HAS BEEN INTERPRETED IN PRIOR SUPREME COURT CASES INVOLVING THE McCARRAN-FERGUSON ACT.

While this case presents an issue of first impression for this Court,[14] the Court has previously analyzed the

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[8] Ohio Rev. Code Ann. § 3903.21(A)(2) and (3) (Anderson 1989).

[9] Ohio Rev. Code Ann. § 3903.21(A)(4) (Anderson 1989).

[10] Ohio Rev. Code Ann. § 3903.21(A)(12) (Anderson 1989).

[11] Ohio Rev. Code Ann. § 3903.32 (Anderson 1989).

[12] Ohio Rev. Code Ann. § 3903.33 (Anderson 1989).

[13] Section 42 of the Model Act deals with the priority of claims against insolvent insurance companies. See also Uniform Insurers Liquidation Act §§ 6-8, 13 U.L.A. 321-353 (1986).

[14] Five federal court cases have addressed the specific issue now before the Court. The first two cases to decide this issue ruled that prioritizing claims against an insolvent insurance company did not constitute the business of insurance. *Gordon v. United States Dep't. of the Treasury*, 846 F.2d 272 (4th Cir.), *cert. denied*, 488 U.S. 954 (1988); *Idaho ex rel. Soward v. United States*, 858 F.2d 445 (9th

meaning of "the business of insurance" in other contexts. Although none of those cases were analogous to the present appeal, the general language and analysis contained in three such cases supports respondent's position that McCarran-Ferguson includes within its scope the type of state statute at issue here.

In *SEC v. National Securities, Inc.*, 393 U.S. 453 (1969), the SEC attempted to enjoin violations of Section 10(b) of the Securities Exchange Act and Rule 10(b)-5 in connection with misrepresentations and omissions in communications by National Securities to shareholders of Producers Life Insurance Co. National Securities was proposing to merge Producers with an insurance company controlled by National Securities. After the SEC was denied temporary injunctive relief, the shareholders of Producers approved the merger. Pursuant to state law, the Arizona Director of Insurance found that the merger was not inequitable to Producer's shareholders and not otherwise contrary to law, and the merger was consummated. 393 U.S. at 457. The SEC thereafter amended its complaint seeking to unwind the merger. National Securities argued that since the merger had been approved by the State Director of Insurance pursuant to state law, McCarran-Ferguson barred the SEC's attempt to use the Securities Exchange Act to unwind the merger. The issue thus presented to the Court was whether the

Cir. 1988), *cert. denied*, 490 U.S. 1065 (1989). Subsequent to those two decisions, the Sixth Circuit created a conflict among the circuits by its decision in the present case. Since the Sixth Circuit decision herein, two United States District Courts have relied upon that decision in holding that the state commonwealth priority statutes for insolvent insurance companies regulated the business of insurance and therefore came within the protection of McCarran-Ferguson. *Garcia v. Island Program Designer, Inc.* No. 91-1679, 1992 WL 106774 (D. Puerto Rico, April 21, 1992) (hereinafter "*Garcia*"); *Lyons v. United States*, No. 4-91-10209 (S.D. Iowa, July 2, 1992) (hereinafter "*Lyons*") (copy included in the Appendix at 8a).

Arizona statute was a "law enacted . . . for the purpose of regulating the business of insurance." 393 U.S. at 457. This Court held that "[w]e do not believe that a state statute aimed at protecting the interests of those who own stock in insurance companies comes within the sweep of the McCarran-Ferguson Act." 393 U.S. at 457. The Court found that McCarran-Ferguson addressed concerns such as the "relationship between insurer and insured," the "reliability" and "enforcement" of insurance policies, and the companies' "status as reliable insurers." 393 U.S. at 460. By contrast:

> [A]rizona is concerning itself with a markedly different set of problems. It is attempting to regulate not the "insurance" relationship, but the relationship between a stockholder and the company in which he owns stock. This is not insurance regulation, but securities regulation. . . . The crucial point is that here the State has focused its attention on stockholder protection; it is not attempting to secure the interests of those purchasing insurance policies. Such regulation is not within the scope of the McCarran-Ferguson Act.

393 U.S. at 460.

Unlike the Arizona statute, Ohio Rev. Code Ann. § 3903.42 protects the insureds of insolvent insurance companies—not their shareholders. Insureds' claims are given a high priority—above those of general creditors, federal, state and local governments, late claims, miscellaneous claims, surplus or contribution notes and "claims of shareholders or other owners." Ohio Rev. Code Ann. § 3903.42 (Anderson 1989). As *Lyons* said of the comparable Iowa statute:

> The focus of the McCarran-Ferguson Act is on protecting policyholders. . . . [citing *National Securities*] The Sixth Circuit in *Fabe*, observed that "it is clear from the language and operation of [Ohio's Insolvent Insurer's statute] that its focus is the protection of

> insureds by diverting the scarce resources of the liquidated entity away from any non-insured creditors, toward policyholders." Iowa's insolvent insurer's statute is similarly focused.

Lyons at p. 13a. Thus, in protecting the policyholders of insolvent insurance companies, the Ohio statute has precisely the intent required by *National Securities*.

Additionally, unlike *National Securities*, the present case does not involve a party trying to invoke McCarran-Ferguson to evade liability for violations of federal law. The present suit is brought by the Liquidator of ADIC to maximize the assets available to insureds in the face of attempts by the federal government to jump ahead in line and thereby jeopardize whether the insureds will collect from their insurance company. If the Court accepts the position of the United States, the insureds will ultimately recover less than if the position of the Liquidator is upheld. Thus, consistent with the directive of *National Securities*, and unlike the state statute in that case, the Ohio law is designed to protect the interests of insureds.

The Court next visited the issue of the scope of "the business of insurance" in *Group Life & Health Insurance Co. v. Royal Drug Co.*, 440 U.S. 205 (1979). That case involved a Sherman Act claim against a Blue Shield insurance company in Texas. The suit claimed that contractual agreements Blue Shield had with pharmacies throughout the state of Texas violated § 1 of the Sherman Act by fixing the retail prices of drugs and causing some of Blue Shield's policyholders to boycott certain pharmacies that did not participate in the Blue Cross Pharmacy Agreements. 440 U.S. at 207. The issue before the Court was "[w]hether the Court of Appeals was correct in concluding that these Pharmacy Agreements are not the "business of insurance" within the meaning of § 2(b) of the McCarran-Ferguson Act." 440 U.S. at 210. The Court reasoned that the Pharmacy Agreements had nothing to do with the spreading of a policyholder's risk,

but were merely contractual arrangements to help minimize the cost of meeting its promises to its policyholders. As the Court noted, "so long as that promise is kept, policyholders are basically unconcerned with arrangements made with Blue Shield and participating pharmacies." 440 U.S. at 214. The Court also noted that the Pharmacy Agreements were not between the insurer and the insured, but were, instead, "separate contractual arrangements between Blue Shield and pharmacies engaged in the sale and distribution of goods and services other than insurance." 440 U.S. at 216. Finally, the Court thought it was significant that the Pharmacy Agreements involved parties "wholly outside the insurance industry." 440 U.S. at 231.

In contrast to *Royal Drug*, the present case impacts directly on whether the ADIC insureds successfully transferred their risks to an insurer as they intended when they entered into their insurance contract, or whether the full brunt of that risk is going to land on their shoulders due to the insolvency of ADIC. Unlike *Royal Drug*, this is clearly not a case where the "policyholders are basically unconcerned" with the operation of the Ohio insurance insolvency statute. Policyholders are vitally concerned with whether the Ohio statute operates as written to maximize the chance their claims will be paid. Second, the Ohio statute focuses directly on the enforcement of the insurance contract between insurer and insured, rather than an organized series of contracts with third party pharmacies. Third, the State Insurance Insolvency Statute prioritizes claims only against insurance companies, not against parties "wholly outside the insurance industry." 440 U.S. at 231.

Finally, unlike *Royal Drug*, the present case does not involve an attempt to use McCarran-Ferguson to circumvent the requirements of the Sherman Act. This was precisely the point upon which the Court in *Garcia* distinguished *National Securities*, *Royal Drug* and *Pireno*:

[T]he circumstances here are distinguishable from the above mentioned cases. As explained by the Sixth Circuit in *Fabe* . . . "(u)nlike *National Securities, Royal Drug* and *Pireno*, this case does not involve a third-party non-insurer seeking to avoid the provisions of federal law through the operation of the McCarran-Ferguson Act. Rather, it concerns a state law designed to protect the interest of the insureds in their relationship with insurers by providing assurances as to the reliability and enforcement of the policies issued."

Garcia at 18a. The Court in *Garcia* and the Court below were both correct in finding a fundamental difference between a practice which a party is attempting to use to avoid liability for a violation of federal law and a practice designed to protect policyholders.

The most recent decision of this Court concerning the meaning of "the business of insurance" is *Union Labor Life Ins. Co. v. Pireno*, 458 U.S. 119 (1982). Union Labor Life Insurance Co. ("ULL") issued health insurance policies that covered chiropractic treatments, provided they were "reasonable" charges for "necessary" medical care. 458 U.S. at 122. As part of its effort to determine what was reasonable and necessary, ULL occasionally sought the opinion of the Peer Review Committee of the New York State Chiropractic Association. 458 U.S. at 123. Some of Pireno's treatments were referred to the Committee, and in certain of those cases the Committee concluded that his charges were not reasonable or his treatments, necessary. 458 U.S. at 123. Pireno sued, alleging that ULL and the Chiropractic Association used the Committee as part of a price fixing scheme in violation of § 1 of the Sherman Act. 458 U.S. at 124. After reviewing this Court's prior decision in *Royal Drug*, the Court stated a 3-part test:

In sum, *Royal Drug*, identified three criteria relevant in determining whether a particular practice is part

of the "business of insurance" exempted from the antitrust laws by § 2(b): *first*, whether the practice has the effect of transferring or spreading a policyholder's risk; *second*, whether the practice is an integral part of the policy relationship between the insurer and the insured; and *third*, whether the practice is limited to entities within the insurance industry. None of these criteria is necessarily determinative in itself. . . .[15]

Based on this three-part test, the Court concluded that ULL's use of Chiropractic Peer Review Committee was not exempted from the antitrust laws by McCarran-Ferguson.

The first criterion under *Pireno*, is whether the Ohio insurance priority statute has the effect of transferring or spreading a policyholder's risk. It should be axiomatic that policyholders want and expect to transfer the risk in reality, not just in legal theory. The states have a strong interest in seeing that this reasonable expectation is met. When an insurance company becomes insolvent the question of whether, in fact the risk has been transferred often depends, as a practical matter, on whether the insureds are given a high priority in comparison with the other claimants of the insolvent insurance com-

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[15] This brief analyzes the three-part *Pireno* test notwithstanding the fact that, unlike *Pireno*, the question here is not whether the Ohio statute is "exempted from the antitrust laws by § 2(b)." *Pireno* was guided by the fact that "[o]ur precedents consistently hold that exemptions from the antitrust laws must be construed narrowly" (458 U.S. at 126), and no such rule has ever been articulated as to exemptions from the federal priority statute at issue here. Accordingly, the *Pireno* analysis set forth herein is not meant to foreclose any alternative analysis of the scope of McCarran-Ferguson. *See* Howard & Stone, *The United States Versus The Liquidators of Insolvent Insurance Companies*, Insurance Litigation Reporter 467, 470-472 (October 1991). At a minimum, public policy, which has long favored state regulation of insurance, dictates that "the business of insurance" should be construed broadly in the present circumstances.

pany. Unless the insureds are given a high priority, as Ohio does, the concept of spreading or transferring the risk remains just that—a concept.

The United States Treasury Department has noted that insurance companies are becoming insolvent at an increasing rate. Petitioner's Brief at 12. To the extent that this is true, it makes it even more important in this time of financial uncertainty that states be allowed to protect insureds' attempts to transfer risks in reality and not just in theory. The Treasury Department has argued that the financial impact of this case is significant in that there are $10.7 million in federal claims against ADIC, and the federal government is a claimant in many other insolvencies as well. Petitioner's Brief at 12. Admittedly, if the United States Department of Treasury is not allowed to jump ahead in line, its recovery may be reduced. However, the alternative is to send that loss crashing down on the shoulders of the insureds who, through no fault of their own, find their insurance company insolvent. Ohio and virtually all other states have determined that governments are in a better position than individual insureds to absorb and spread out such uncompensated losses. To allow the Treasury Department to leapfrog ahead of the insureds of ADIC would flaunt that determination as well as *Pireno's* concern with transferring or spreading a policyholder's risk. It would result in the risk of loss being concentrated on the unfortunate insureds of ADIC. Certainly, this Court could not have had that result in mind when it issued its decision in *Pireno*. Just as certainly, Congress could not have intended that such a basic and long established insurance regulation as the setting of priorities for claims against insurance companies would not be covered by McCarran-Ferguson.[16]

[16] Finally, the Treasury Department's argument that the "effect on federal revenue would be significant" (Petitioner's Brief at 12) if the federal government is not given a superpriority is belied by Congress' treatment of federal claims under the bankruptcy laws. In bankruptcy claims Congress has granted tax claims a mere seventh priority and other federal claims an even lower status. As one commentator has noted:

> There is no sense in the federal bankruptcy laws, which cover a vastly greater number of cases and could be expected to involve far larger losses to the federal treasury, that the claims of injured workers and consumers of an insolvent business should have their claims debilitated by a special federal priority. Likewise the courts have refused to allow the federal government to assert the priority in national bank insolvencies. The result of this inconsistency in federal treatment of its claims against an insolvent is the potential injury of the very parties Congress (according to the *National Securities* decision) asked the state to protect by the adoption of the McCarran-Ferguson Act.

Darr, *Federal Claims in Insurance Insolvencies*, 25 Tort & Insurance L.J. 601 (1990).

The second *Pireno* criterion is whether the practice is an integral part of the policy relationship between the insurer and the insured. In *Pireno*, ULL's use of the Peer Review Committee was found not to be an integral part of the policy relationship between insurer and insured since the arrangement between ULL and the Committee was "obviously distinct from ULL's contracts with its policyholders." 458 U.S. at 131. This Court further found that the use of the Peer Review Committee was "a matter of indifference to the policyholder whose only concern is *whether* his claim is paid, not *why* it is paid." 458 U.S. at 132 (emphasis in original).

The present case is 180 degrees removed from the facts in *Pireno*. Here the challenged practice is a state law giving a high priority to the claims of insureds so that those insureds are more likely to be paid under their contract with their insurance company. Thus, the Ohio law directly impacts ADIC's contract with its insureds. The Ohio law deals with the most integral part of the contractual relationship between an insured and the in-

surer—whether the policyholder is paid for claims for which the insurance company is admittedly responsible.

Similarly, unlike *Pireno*, the challenged practice—giving priority to policyholders' claims—is most definitely not "a matter of indifference to the policyholder." This Court was absolutely correct in *Pireno* in stating that the policyholder's "only concern is *whether* his claim is paid, not *why* it is paid." 458 U.S. at 132 (emphasis in original). The Ohio law speaks directly to that precise concern and makes it more likely that a policyholder will be paid when his or her insurance company becomes insolvent. While some claims of some insureds are covered (at least in part) by insurance guaranty associations, a large number of claims either are not covered completely or are not covered at all. The only recourse these insureds have is against the liquidator.

The United States Treasury Department wants to twist the Court's assessment of what is at the core of the insured/insurer relationship—whether the insured is paid—and say that this does not matter. The Treasury Department's ~~position~~ flies in the face of common sense and the universal concern of policyholders, recognized by *Pireno*, to be paid by their insurer. This concern is no less valid when the Company encounters financial difficulties. Indeed, this is precisely the time when that concern is the greatest. Ohio and other states have addressed this legitimate concern head-on by enacting statutes that give insureds a high priority among the claims against insolvent insurers. To say that this is a regulation of something other than the business of insurance defies logic and the intent of McCarran-Ferguson.

The final factor to be examined is whether the challenged statute is limited to entities within the insurance agency. In *Pireno*, the challenged practice ran afoul of this test since the use of the Peer Review Committee obviously involved a third party wholly outside of the insurance industry. 458 U.S. at 132. As this Court noted:

> Arrangements between insurance companies and parties outside the insurance industry can hardly be said to lie at the center of that legislative concern [in McCarran-Ferguson]. More importantly, such arrangements may prove contrary to the spirit as well as the letter of § 2(b), because they have the potential to restrain competition in noninsurance markets.

458 U.S. at 133. In the present appeal, by contrast, the Ohio priority scheme applies solely to insolvent insurance companies. The Ohio statute does not purport to cover insolvencies of any other companies or entities. In the matter at hand, there is no third party intimately involved at the center of the practice at issue, such as was true of the Peer Review Committee in *Pireno* and the participating pharmacies in *Royal Drug*. Unlike *Pireno* this case does not involve "arrangements between insurance companies and parties outside the insurance industry." Furthermore, in contrast to *Pireno* this is not a case where the challenged practice "may prove contrary to the spirit as well as the letter of § 2(b), because they have the potential to restrain competition in noninsurance markets." Thus, the factors that concerned the Court in *Pireno* are simply not present here.

The Treasury Department argues that others outside the insurance industry are involved insofar as they have claims against the insolvent insurance companies. This argument is without merit for two reasons. First, the argument proves too much. The Treasury Department has adopted an unreasonably broad interpretation of whether the practice is limited to entities within the insurance industry. To some extent any law can be said to indirectly impact or involve third parties; but that is not the issue. The correct question is whether there is the type of major involvement as was true of the Peer Review Committee in *Pireno* and the participating pharmacies in *Royal Drug*. Clearly, that is not the case in the present appeal. Second, even if by some stretch of lan-

guage it could be said that the Ohio statute was not limited to entities within the insurance industry, the fact remains that the challenged practice "need not be denied the § 2(b) exemption *solely* because they involve parties outside the insurance industry." 458 U.S. at 133.[17] In short, the third part of the *Pireno* test is fully satisfied by the Ohio insurance insolvency priority statute.

In sum, the Ohio insurance priority statute at issue is within the ambit of the McCarran-Ferguson Act no matter how one analyzes the issue. McCarran-Ferguson protects the states' right to enact laws to regulate "the business of insurance." The plain and unambiguous meaning of that term includes a statute intended to make it more likely, in the event of an insolvency, that policyholders' claims are paid. Furthermore, based on the *National Securities-Royal Drug-Pireno* trilogy, the decision of the Sixth Circuit should be affirmed: 1. The Ohio law has the very practical and real effect of helping to spread the policyholders' risk. 2. The Ohio statute makes more reliable and enforceable the most integral part of the policy relationship between insurer and insured—whether the policyholder's claim is paid. 3. The Ohio law prioritizes only the claims against insolvent insurers.

[17] *See also* 458 U.S. at 129 ("None of these criteria is necessarily determinative in itself . . . .")

CONCLUSION

For the reasons set forth above, the judgment of the Court of Appeals should be affirmed.

Respectfully submitted,

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September, 1992

APPENDICES

APPENDIX A

STATUTORY PROVISIONS INVOLVED

1. The federal priority statute, 31 U.S.C. 3713, provides:

Priority of Government claims

(a)(1) A claim of the United States Government shall be paid first when—

(A) a person indebted to the Government is insolvent and—

(i) the debtor without enough property to pay all debts makes a voluntary assignment of property;

(ii) property of the debtor, if absent, is attached; or

(iii) an act of bankruptcy is committed; or

(B) the estate of a deceased debtor, in the custody of the executor or administrator, is not enough to pay all debts of the debtor.

(2) This subsection does not apply to a case under title 11.

(b) A representative of a person or an estate (except a trustee acting under title 11) paying any part of a debt of the person or estate before paying a claim of the Government is liable to the extent of the payment for unpaid claims of the government.

2. The McCarran-Ferguson Act, 15 U.S.C. 1011-1012, provides in part:

§ 1011. Declaration of policy

Congress hereby declares that the continued regulation and taxation by the several States of the busi-

ness of insurance is in the public interest, and that silence on the part of the Congress shall not be construed to impose any barrier to the regulation or taxation of such business by the several States.

§ 1012. Regulation by state law; Federal law relating specifically to insurance; applicability of certain Federal laws after June 30, 1948

(a) State regulation

The business of insurance, and every person engaged therein, shall be subject to the laws of the several States which relate to the regulation or taxation of such business.

(b) Federal regulation

No Act of Congress shall be construed to invalidate, impair, or supersede any law enacted by any State for the purpose of regulating the business of insurance * * * unless such Act specifically relates to the business of insurance.

3. The Ohio Insurers Supervision, Rehabilitation and Liquidation Act, Ohio Rev. Code Ann. §§ 3903.21(A)(2), 3903.21(A)(3), 3903.21(A)(4), 3903.21(A)(12), 3903.32, 3903.33 and 3903.42 (Anderson 1989 & Supp. 1991) provide:

§ 3903.21 Powers of liquidator

(A) The liquidator may do any of the following:

* * *

(2) Employ employees and agents, actuaries, accountants, appraisers, consultants, and such other personnel as he may consider necessary to assist in the liquidation;

(3) Fix the reasonable compensation of employees and agents, actuaries, accountants, appraisers, and consultants with the approval of the court;

(4) Pay reasonable compensation to persons appointed and defray from the funds or assets of the insurer all expenses of taking possession of, conserving, conducting, liquidating, disposing of, or otherwise dealing with the business and property of the insurer. In the event that the property of the insurer does not contain sufficient cash or liquid assets to defray the costs incurred, the superintendent of insurance may advance the costs so incurred out of any appropriation for the maintenance of the department of insurance. Any amounts so advanced for expenses of administration shall be repaid to the superintendent for the use of the department out of the first available money of the insurer.

* * * *

(12) Continue to prosecute and to commence in the name of the insurer or in his own name any and all suits and other legal proceedings, in this state or elsewhere, and to abandon the prosecution of claims he considers unprofitable to pursue further. If the insurer is dissolved under section 3903.20 of the Revised Code, he shall have the power to apply to any court in this state or elsewhere for leave to substitute himself for the insurer as plaintiff.

§ 3903.32 Recovery from reinsurers

The amount recoverable by the liquidator from reinsurers shall not be reduced as a result of delinquency proceedings, regardless of any provision in the reinsurance contract or other agreement. Payment made directly to an insured or other creditor does not diminish the reinsurer's obligation to the insurer's estate except when the reinsurance contract provides for direct coverage of a named insured and the payment is made in discharge of that obligation.

§ 3903.33 Payment of unpaid earned premiums

(A) an agent, broker, premium finance company, or any other person, other than the insured, responsible for the payment of a premium is obligated to pay any unpaid earned premium due the insurer at the time of the declaration of insolvency, as shown on the records of the insurer. The liquidator may recover from such person any part of an unearned commission of such person.

(B) An insured shall be obligated to pay any unpaid earned premium due the insurer at the time of the declaration of insolvency, as shown on the records of the insurer.

§ 3903.42 Priority of distribution of claims

The priority of distribution of claims from the insurer's estate shall be in accordance with the order in which each class of claims is set forth in this section. Every claim in each class shall be paid in full or adequate funds retained for such payment before the members of the next class receive any payment. No subclasses shall be established within any class. The order of distribution of claims shall be:

(A) Class 1. The costs and expenses of administration, including but not limited to the following:

(1) The actual and necessary costs of preserving or recovering the assets of the insurer;

(2) Compensation for all services rendered in the liquidation;

(3) Any necessary filing fees;

(4) The fees and mileage payable to witnesses;

(5) Reasonable attorney's fees;

(6) The reasonable expenses of a guaranty association or foreign guaranty association in handling claims.

(B) Class 2. Debts due to employees for services performed to the extent that they do not exceed one thousand dollars and represent payment for services performed within one year before the filing of the complaint for liquidation. Officers and directors shall not be entitled to the benefit of this priority. Such priority shall be in lieu of any other similar priority that may be authorized by law as to wages or compensation of employees.

(C) Class 3. All claims under policies for losses incurred, including third party claims, all claims against the insurer for liability for bodily injury or for injury to or destruction of tangible property that are not under policies, and all claims of a guaranty association or foreign guaranty association. All claims under life insurance and annuity policies, whether for death proceeds, annuity proceeds, or investment values, shall be treated as loss claims. That portion of any loss, indemnification for which is provided by other benefits or advantages recovered by the claimant, shall not be included in this class, other than benefits or advantages recovered or recoverable in discharge of familial obligations of support or by way of succession at death or as proceeds of life insurance, or as gratuities. No payment by an employer to an employee shall be treated as a gratuity. Claims under nonassessable policies for unearned premium refunds.

(D) Class 4. Claims of general creditors.

(E) Class 5. Claims of the federal or any state or local government. Claims, including those of any governmental body for a penalty or forfeiture, shall be allowed in this class only to the extent of the pecuniary loss sustained from the act, transaction, or proceeding out of which the penalty or forfeiture arose, with reasonable and actual costs occasioned thereby. The remainder of such claims shall be post-

poned to the class of claims under division (H) of this section.

(F) Class 6. Claims filed late or any other claims other than claims under divisions (G) and (H) of this section.

(G) Class 7. Surplus or contribution notes, or similar obligations, and premium refunds on assessable policies. Payments to members of domestic mutual insurance companies shall be limited in accordance with law.

(H) Class 8. The claims of shareholders or other owners.

4. The Ohio Insurance Guaranty Association Act, Ohio Rev. Code Ann. § 3955.06(A) (Anderson Supp. 1991) provides:

§ 3955.06 Creation of nonprofit association

(A) There is hereby created a nonprofit unincorporated association to be known as the Ohio Insurance Guaranty Association. All members insurers, as defined in division (D) of section 3955.01 of the Revised Code, shall be and remain members of the association as a condition of their authority to transact insurance in this state. The association shall perform its functions under a plan of operation established and approved under section 3955.09 of the Revised Code and shall exercise its powers through a board of directors established under section 3955.07 of the Revised Code.

5. The Ohio Life and Health Insurance Guaranty Association Act, Ohio Rev. Code Ann. § 3956.06 (Anderson Supp. 1991) provides:

§ 3956.06 Life and health insurance guaranty association created; life insurance and annuity account; health insurance account; supervision.

(A) There is hereby created a nonprofit unincorporated association to be known as the Ohio life and health insurance guaranty association. All member insurers shall be and remain members of the association as a condition of their authority to transact the business of insurance in this state. The association shall perform its functions under the plan of operation established and approved under section 3956.10 of the Revised Code and shall exercise its powers through a board of directors established under section 3956.07 of the Revised Code. For purposes of administration and assessment, the association shall maintain the following two accounts:

(1) The life insurance and annuity account which includes the following subaccounts:

(a) Life insurance subaccount;

(b) Annuity subaccount;

(c) Unallocated annuity subaccount which also includes all annuity contracts meeting the requirements of section 403(b) of the "Internal Revenue Code of 1986," 100 Stat. 2085, 26 U.S.C. 1, as amended.

(2) The health insurance account.

(B) The association is subject to the supervision of the superintendent of insurance and to the applicable insurance laws of this state.

APPENDIX B

IN THE UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF IOWA
CENTRAL DIVISION

Civil No. 4-91-10209

DAVID J. LYONS, Commissioner of Insurance for the State of Iowa, as Liquidator of Carriers
Plaintiff,

vs.

UNITED STATES OF AMERICA,
Defendant.

Before the court for ruling is plaintiff's motion for summary judgment filed December 5, 1991. The government resisted on March 19, 1992. Plaintiff filed his reply on April 3, 1992.

BACKGROUND

Plaintiff, the Iowa Insurance Commissioner, instituted the present lawsuit as liquidator for the insolvent Carriers Insurance Co., (Carriers) contesting an IRS determination that in 1980, Carriers illegally changed accounting methods. The IRS determined this illegal change resulted in an underreporting of income, and as a consequence assessed Carriers with additional tax liability. In 1982, Carriers experienced an operating loss entitling it to a business-loss carry back to 1980. The 1982 loss carry back was not sufficient to cover the entire amount of tax and interest due, however, and the liability not extinguished by the carry back continued to accrue interest until March, 1991 when the total amount due was

paid. Plaintiff then instituted this suit seeking a refund.

The parties have settled one of the two issues presented for summary judgment as the United States has agreed to refund the interest which accrued after Carriers was declared insolvent. The remaining issue focuses on which priority statute governs the distribution of assets of an insolvent insurance company. More specifically, should Iowa law or federal law determine creditor priority.

APPLICABLE LAW AND DISCUSSION

Preliminarily, the court notes that this matter is before it on plaintiff's motion for summary judgment, and summary judgment is "clearly appropriate where the court is faced with a motion . . . for summary judgment, wherein all parties admit to undisputed facts and are merely seeking a declaration of the law." *Gordon v. United States Dept. of Treasury*, 668 F. Supp. 483, 487 (D.Md. 1987). The parties in this case have stipulated to the facts and are seeking a declaration from this court of which law will decide insolvent insurer creditor priority. The issue is ripe for summary judgment.

A. JURISDICTIONAL ISSUE

The United States initially urges that this court lacks jurisdiction to consider the remaining summary judgment issue because plaintiff has sought relief under 28 U.S.C. § 2201, the Declaratory Judgment Act. The Act provides that a court may declare rights in any case of actual controversy within its jurisdiction except with respect to federal taxes other than actions brought under § 7428.[1]

The government's jurisdictional argument is flawed. The declaratory relief sought in count II of plaintiff's

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[1] 26 U.S.C. § 7428 provides for declaratory judgments relating to status and classification of organizations under sections 501(c)(3), 509(a) and 4942(j)(3).

amended complaint is a separate and distinct issue from the request for a tax refund in count I. In count II, the plaintiff seeks a declaration regarding which law governs creditor priority for insolvent insurance companies. The exception in § 2201 regarding federal taxes is inapplicable in this instance because the declaratory relief sought does not relate to federal taxes even though resolution of the issue in favor of plaintiff may, as a practical matter, render the count I tax refund claim moot.

Rather, count II presents an actual controversy within this court's jurisdiction involving the interrelationship of the McCarran-Ferguson Act, the Federal Insolvency Statute and the Iowa priority statute.[2] As acknowledged by the government's counsel during oral argument, plaintiff is entitled to a federal forum to resolve this issue. The controversy falls within this court's subject matter jurisdiction, and the court may properly consider declaratory relief regarding it. The real issue is whether a determination of the statutory interrelationship issue should be deferred pending resolution of the tax controversy. The court finds that there should be no deferral.

B. McCARRAN-FERGUSON ACT

The regulation of the "business of insurance" has been delegated to the individual states by the McCarran-Ferguson Act:

> The business of insurance, and every person engaged therein, shall be subject to the laws of the several states which relate to the regulation or taxation of such business.
>
> No act of Congress shall be construed to invalidate, impair, or supersede any law enacted by any state for the purpose of regulating the business of insurance, or which imposes a fee or tax upon such business, unless such act specifically relates to the business of insurance: Provided, that [the Sherman Act, Clayton Act and Federal Trade Commission Act] shall be applicable to the business of insurance to the extent that such business is not regulated by State law.

[2] Iowa Insurers Supervision Rehabilitation and Liquidation Act, Iowa Code § 507C.42.

15 U.S.C. § 1012(a) & (b).

Plaintiff claims that part of regulating the "business of insurance" is determining the priority of payment among creditors of insolvent insurance companies and that the Iowa insurance priority statute is controlling. In addressing priority, the statute specifies five classes of creditors with payment for federal taxes ranking last. In contrast, the United States maintains that creditor priority should be determined by an application of the Federal Insolvency Statute, 31 U.S.C. § 3713, which places tax collection at the top of the priority list. The government contends that the McCarran-Ferguson Act does not apply because this case does not involve the regulation of the "business of insurance," a phrase that has been narrowly defined by the Supreme Court.

The Supreme Court in two antitrust cases set out a test to determine if an activity regulated by the state is to be considered the "business of insurance" within the meaning of the McCarran-Ferguson Act. *Group Life & Health Ins. Co. v. Royal Drug Co.*, 440 U.S. 205 (1979); *Union Labor Life Ins. Co. v. Pireno*, 458 U.S. 119 (1982). The Court found three criteria relevant in determining whether a particular practice is part of the "business of insurance" exempted from the anti-trust laws by § 2(b) of the McCarran-Ferguson Act: (1) whether the practice has the effect of transferring or spreading a policyholder's risk; (2) whether the practice is an integral part of the policy relationship between the insurer and the insured; and (3) whether the practice is limited to entities within the insurance industry. *Pireno*, 458 U.S. at 126-129.

Three circuit court decisions have addressed the question of whether state or federal law should determine the priority of creditors of insolvent insurance companies. Two cases decided in 1988 by the Ninth and Fourth Circuits favor the government's position and hold that the Federal Insolvency Statute preempts the states' insurance priority statutes. *Gordon v. United States Department of Treasury*, 846 F.2d 272 (4th Cir. 1988); *State of Idaho ex rel. Soward v. United States*, 858 F.2d 445 (9th Cir. 1988). A 1991 Sixth Circuit case held that the state insurance statute properly regulated the priority of creditors of an insurance company and was within the definition of the business of insurance according to the McCarran-Ferguson Act. *Fabe v. United States Department of Treasury*, 939 F.2d 341 (6th Cir. 1991). The court in *Fabe* applied the three-part test set forth in *Pireno* to determine the scope of the phrase, "the business of insurance." The Eighth Circuit has not yet considered this issue.

There are also several federal courts that have abstained from exercising federal jurisdiction in cases involving state insurance liquidation priority schemes on McCarran-Ferguson grounds. *See e.g., Grimes v. Crown Life Ins. Co.*, 857 F.2d 699 (10th Cir. 1988) (court abstains declaring receivership regulations are laws concerning the "business of insurance"); *Levy v. Lewis*, 635 F.2d 960 (2d Cir. 1980) (court abstains in case involving conflict between state insurance liquidation statute and ERISA); *Washburn v. Corcoran*, 653 F. Supp. 554 (S.D.N.Y. 1986) (court abstains in conflict between Federal Arbitration Act and New York law regulating the liquidation of domestic insurance companies). The *Fabe* court found these abstention cases persuasive even though they did not apply the *Pireno* three-part analysis to determine if the act of liquidation was to be considered the "business of insurance" according to McCarran-Ferguson.

This is a difficult question. There are strong public policy arguments on both sides. Usually federal law is

supreme, but Congress has carved out a niche for states to regulate insurance companies through the McCarran-Ferguson Act. In addition, Congress has specifically exempted insurance companies from liquidation under the federal bankruptcy code, 11 U.S.C. § 109, and have entrusted the liquidation of insolvent insurance companies to the states.

The focus of the McCarran-Ferguson Act is on protecting policyholders. In *National Securities & Exchange Commission v. National Securities*, 393 U.S. 453 (1969), the Supreme Court stated,

> whatever the exact scope of the statutory term, [the "business of insurance"], it is clear where the focus [of the McCarran-Ferguson Act] was—it was on the relationship between the insurance company and the policyholder. Statutes aimed at protecting this relationship, directly or indirectly, are laws regulating the "business of insurance."

National Securities, 393 U.S. at 460. The Sixth Circuit in *Fabe*, observed that "it is clear from the language and operation of [Ohio's Insolvent Insurer's statute] that its focus is the protection of insureds by diverting the scarce resources of the liquidated entity away from any non-insured creditors, toward policyholders." Iowa's insolvent insurer's statute is similarly focused. After carefully examining the cases previously cited, the court concurs with the reasoning in Judge Martin's opinion in *Fabe* and concludes that a state's insolvent insurer's statute regulates activities falling within the definition of the "business of insurance" as required in the McCarran-Ferguson Act.[3]

[3] In discussing the meaning of the "business of insurance," the *Fabe* court held that the three-factor test that determines what constitutes the "business of insurance" as set forth in *Pireno* and *Royal Drug* applied to non-antitrust situations. *Pireno* and *Royal Drug* involved antitrust claims.

An alternative approach is suggested by Davis Howard's article, *Uncle Sam Versus the Insurance Commissioners: A Multi-Level*

CONCLUSION AND ORDER FOR JUDGMENT

IT IS ORDERED that summary judgment shall be entered on count II in favor of the plaintiff, declaring that the Iowa Insurers Supervision Rehabilitation and Liquidation Act, Iowa Code § 507C.2 is a state law regulating the business of insurance within the meaning of the McCarran-Ferguson Act, 15 U.S.C. § 1012.

Dated this 2nd day of July, 1992.

/s/ Ronald E. Longstaff
RONALD E. LONGSTAFF
Judge
United States District Court

Approach to Defining the "Business of Insurance" under the McCarran-Ferguson Act, 25 Willamette L. Rev. 1 (1989). This court finds the multi-definitional analysis advocated in Howard's article to be intriguing and perhaps preferable to the tripartite *Pireno* analysis on the issue of defining the "business qf insurance" in non-antitrust cases. The author suggests applying the test set forth in *National Securities* to determine what constitutes the business of insurance, and proposes a broadening of the defintion in superpriority cases. The court found no case adopting the author's position.

UNITED STATES DISTRICT COURT
D. PUERTO RICO

Civil No. 91-1679 (GG)

JUAN ANTONIA GARCIA, in his Capacity as Insurance Commissioner Puerto Rico,
Plaintiff,

vs.

ISLAND PROGRAM DESIGNER, INC.,
Defendant.

OPINION AND ORDER

GIERBOLINI, Chief Judge

This case requires us to rule on the issue of whether the liquidation proceedings of an insurance company initiated in the Superior Court of Puerto Rico by the Insurance Commissioner in his official capacity, qualifies as "business of insurance" as defined under the McCarran-Ferguson Act.[1] We also need to decide if under the McCarran-Ferguson Act, the Puerto Rico Insurance Code[2] takes precedence over the federal superpriority statute.[3] Procedurally, the case is before us pursuant to a motion to remand filed by the Commissioner after the Internal Revenue Service filed a notice to remove the case to this court.[4]

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[1] 15 U.S.C. § 1011 et seq. (1988).

[2] 26 L.P.R.A. § 4001 et seq.

[3] 31 U.S.C. § 3713(a)(1)(A).

[4] 28 U.S.C. § 1441(b).

I. BACKGROUND

The facts in this case are uncontested. The Puerto Rico Insurance Commissioner, in his capacity as receiver to distribute the assets of an insolvent Health Maintenance Organization ("HMO"), ISLAND Program Designer ("IPD"), commenced judicial proceedings in Superior Court of Puerto Rico, Bayamon Part, pursuant to the provisions of Chapter 40 of the Insurance Code of Puerto Rico, 26 L.P.P.A. § 4001 et seq.[5] On January 8, 1988, the local court entered an order extending the deadline to submit claims against the assets of IPD up to and including May 19, 1988. On June 1, 1989, the IRS filed its claims in the Office of the Insurance Commissioner of Puerto Rico. On July 5, 1990, the Insurance Commissioner filed in Superior Court a listing of the priority of claims submitted in the IPD's liquidation. Thereafter, he amended the list of priority claims and, clarified that only the claims filed prior to May 19, 1988, would be considered as timely filed.

The IRS, after receiving permission by the Superior Court, intervened in the case on May 24, 1991, seeking to collect monies owed by the insolvent insurer. The IRS claimed a preference with respect to all other parties, including policyholders, subscribers, providers of services, beneficiaries and insureds, pursuant to 31 U.S.C. § 3713 (a)(1)(A) (federal priority statute).[6] On May 28, 1991, the IRS filed a Notice of Removal to this court.

Plaintiff avers that the federal super-priority statute does not apply to the liquidation proceedings under the Puerto Rico Insurance Code, because the proceedings are

[5] Civil No. CS 87-509, Superior Court of Puerto Rico, Bayamon Part.

[6] 31 U.S.C. § 3713 provides as follows in the pertinent part: (a)(1) A claim of the United States shall be paid first when: (A) a person indebted to the Government is insolvent and—(i) a debtor without enough property to pay all assignment of debts makes a voluntary assignment of property; (ii) property of the debtor is absent, is attached, or (iii) an act of bankruptcy is committed(.)

part of the "business of insurance" within the purview of the McCarran-Ferguson Act. Accordingly, he argues that Article 40.190, 26 L.P.R.A. § 4019, takes precedence over the federal priority statute, and is therefore not preempted by 31 U.S.C. § 3713, as claimed by the IRS. He further asserts that abstention under the doctrine of *Burford v. Sun Oil Co.*, 319 U.S. 315, 63 S.Ct. 1098, 87 L.Ed. 1424 (1943), is proper because interpretation of a complex and specialized statute drafted to govern the insurance business in Puerto Rico is at issue here.

II. DISCUSSION

(1) As mentioned above, the first issue is whether the liquidation proceedings of an insolvent insurer are part of the "business of insurance" pursuant to the McCarran-Ferguson Act.

Facing similar circumstances, our Circuit in *Gonzalez v. Media Elements, Inc.*, 946 F.2d 157 (1st Cir. 1991) found that federal abstention was appropriate under the doctrine of *Burford v. Sun Oil Co.*, 319 U.S. 315, 63 S.Ct. 1098 (1943). In *Gonzalez*, the First Circuit set forth the policy for us to consider in considering to remand these causes of action:

> By enacting the Uniform Insurers Liquidation Act, 26 L.P.R.A. § 4001 et seq., Puerto Rico has constructed a comprehensive framework for the liquidation of insolvent insurance companies and the resolution of claims against them. Continued federal litigation may disrupt Puerto Rico's regulatory system in three significant ways: (1) by taking jurisdiction away from the "central administration forum" in which Puerto Rico's legislature intended to concentrate all 'claims against the corporation being liquidated, a method that promotes the orderly adjudication of same.' *Calderon v. Commonwealth Insurance Co.*, 111 D.P.R. 153 (1981); (2) by forcing the Puerto Rico Insurance Commissioner to dissipate the insolvent insurer's funds litigating a claim that could be

settled more efficiently in the administrative forum; and (3) by creating the risk that Puerto Rico and the federal court will adopt different interpretations of the policy term at issue here, thus defeating the Commonwealth's interest in a consistent disposition of all claims against the insolvent insurer. *Id.* at 157. (Citations omitted.)

The intervenor's assertion that the liquidation proceedings are not part of the "business of insurance" or in the alternative, that the federal super-priority statute preempts any state priority statute is not availing and runs contrary to *Gonzalez v. Media Elements, Inc.* IRS cites the trilogy of Supreme Court cases interpreting the "business of insurance" under the McCarran-Ferguson Act: *Union Labor Life Insurance Co. v. Pireno*, 458 U.S. 119, 102 S.Ct. 3002, 73 L.Ed.2d 647 (1982); *Group Life & Health Insurance Co. v. Royal Drug Co.*, 440 U.S. 205, 99 S.Ct. 1067, 59 L.Ed.2d 261 (1979); and *SEC v. National Securities, Inc.*, 393 U.S. 453, 89 S.Ct. 546, 21 L.Ed.2d 668 (1969). However, the circumstances here are distinguishable from the above mentioned cases. As explained by the Sixth Circuit in *Fabe v. U.S. Dept. of Treasury*, 939 F.2d 341 (6th Cir. 1991): "(u)nlike *National Securities, Royal Drug*, and *Pireno*, this case does not involve a third-party noninsurer seeking to avoid the provisions of federal law through the operation of the McCarran-Ferguson Act. Rather, it concerns a state law designed to protect the interest of the insureds in their relationship with insurers by providing assurances as to the reliability and enforcement of the policies issued. See *National Securities*, 393 U.S. at 460 (89 S.Ct. at 568)." *Id.* at 351. The cases of *State of Idaho ex rel. Soward v. United States*, 858 F.2d 445 (9th Cir. 1988); and *Gordon v. United States Dept. of Treasury*, 846 F.2d 272 (4th Cir. 1988) are in conflict with *Gonzalez v. Media Elements, Inc.*, of the First Circuit cited above. Those cases also addressed the particular issue raised here and rejected the argument that states' liquidation

priority statutes regulated the "business of insurance" within the scope of McCarran-Ferguson Act.

With deference to the Fourth and Ninth Circuits we follow the precedent established in 1991 by our Circuit in *Gonzalez*, that explicitly found those liquidation proceedings of an insolvent insurer under the Puerto Rico Insurance Code, are part of the "business of insurance". This ruling governs the instant case not only because it is a First Circuit case, but also because it specifically deals with the point at issue here. We only add that those cases failed to discuss whether the federal statute supersedes or not the McCarran-Ferguson Act.

This is not the end of our inquiry, since we must now resolve the second issue of whether the federal super-priority statute, supersedes the McCarran-Ferguson Act. The state law at issue here is the Puerto Rico Insurance Code, and intricate an highly specialized administrative system, adopted by the Commonwealth of Puerto Rico to regulate the life of insurance companies from incorporation to dissolution pursuant to the McCarran-Ferguson Act. Chapter 40 of this code provides a comprehensive program for the rehabilitation and liquidation of domestic insurance companies in Puerto Rico and includes the Uniform Insurers Liquidation Act, contained in sections 4008 to 4014. Said regulation is crucial for consumer protection because insurance companies are not subject to federal bankruptcy proceedings. For this reason, federal courts have often abstained from considering such causes of action, in deference to the state's interest in this matter. See *Fabe, supra*, 939 F.2d at 346-47; citing *Grimes v. Crown Life Insurance Co.*, 857 F.2d 699 (10th Cir. 1988), *cert. denied*, 489 U.S. 1096, 109 S.Ct. 1568, 103 L.Ed.2d 934 (1989). The purpose of the Puerto Rico's Liquidation Priority Statute is to provide a uniform procedure for the Commissioner to request the liquidation of the assets of insolvent insurance companies in Superior Court of Puerto Rico, under several grounds set

forth in the statute. 26 L.P.R.A. § 4002 (Article 40.02). Section 4012 of the statute, establishes the priorities for payment of claims, as defined by section 4007. Under § 4012, all claims submitted against an insolvent insurance company are prioritized.[7] Furthermore, § 4019 of the Liquidation Proceedings statute provides the period of time in which the submission of claims against the insolvent insurer are allowed. This statutory section provides that after the insurer is finally declared insolvent, regardless of any prior notice given to potential creditors, "the Commissioner shall notify all persons who may have claims against such insurer and who have not filed proper proofs thereof, to present the same to him, at a place specified in such notice, within four months from the date of the entry of such order, or, if the Commissioner shall certify that it is necessary, within such longer time as the court may prescribe . . ." 26 L.P.R.A. § 4019(1). Additionally, this section also provides that filing the correspondent proofs of claim after the deadline, will not share in the distribution of assets until all the allowed claims have been paid in full. 26 L.P.R.A. § 4019(2). The deadine for filing claims against IPD was extended up to, and including May 9, 1988. It was not until June 1, 1989, more than a year after the deadline had passed, that the IRS filed its claims with the Office of the Insurance Commissioner of Puerto Rico. On August 7 ,1990, the Commissioner filed a list of the priority claims, specifying that only the claims filed before May 19, 1988, would be considered timely. Claims filed after said deadline, would be considered after all the allowed claims have been paid in full, pursuant to 26 L.P.R.A. § 4019(2). When the IRS ascertained that it would lose the preferred claim status bestowed by federal law and provided for in Chapter 40 of the Puerto

[7] 26 L.P.R.A. § 4007(9) provides that a "preferred claim means any claim with respect to which the law of a state or of the United States accords priority of payment from the general assets of the insurer." (Emphasis ours).

Rico Insurance Code, they moved to remove this action pursuant to 31 U.S.C. § 3179(a)(1)(A), contending that the federal super-priority statute preempts the local statute. As to this contention, the Sixth Circuit has established that "(v)arious statutes enacted by Congress, including the Sherman Act, Clayton Act, and the Federal Trade Commission Act, have been amended as to establish federal dominance in certain areas pursuant to the McCarran-Ferguson Act. Nevertheless, 31 U.S.C. § 3173, the federal superiority statute has not been amended to that effect." *Fabe, supra*, at 344 (n.2). (Emphasis Added). Because our Circuit has not expressed itself on this issue, we are hereby adopting the Sixth Circuit's position in *Fabe, supra*, as persuasive and find that Puerto Rico's liquidation priority statute is not preempted by the federal super-priority statute.

III. CONCLUSION

The McCarran-Ferguson Act and the case law of our Circuit direct us to remand this matter to the local forum in deference to the highly specialized and comprehensive procedure for the liquidation of insolvent insurance companies contained in the Puerto Rico Insurance Code.

WHEREFORE, in view of the forgoing reasons, the instant action must be and is hereby REMANDED to Superior Court of Puerto Rico, Bayamon Part.

SO ORDERED.